Tangled Web of Illustration Issues

October 04, 2019

The NAIC Annuity Disclosure (A) Working Group (Disclosure WG) and the NAIC IUL Illustration (A) Subgroup (IUL SG) continue to untangle the web of issues applicable to fixed index annuity and index universal life (IUL) illustrations. These issues have arisen as a result of different "references" and "multipliers" being spun into the determination of the index interest credited under these products.

Disclosure WG Toiling Over Five Issues

1. Length of Time an "Index" Must Be in Existence: While consumer representative Birny Birnbaum bellowed that a minimum of 20 years is necessary for required 10-year scenarios to be meaningful, the Disclosure WG cast their votes to stretch the required time frame from the current 10-year period to a 15-year period.
2. Changes to an Index's Algorithm: Many new indexes are determined based on the value of various assets, asset classes, or other "references," and their index values are determined according to an algorithm or "rulebook." The Disclosure WG has been vexed as to whether the index and its algorithm must be fixed. Industry representatives asserted that the algorithm may change if an asset or reference is no longer available, such as the London Interbank Offered Rate. Regulators noted that if an algorithm needs to be changed, a new index could be created and used to determine index interest. Thus, the Disclosure WG decided to prohibit any changes to the rulebook.
3. Back-Casted Data vs. Actual Data: The Disclosure WG unanimously agreed that information based on back-casted data of an index should be visually distinguished in an illustration from information based on actual historical performance of the index.

4. Availability of an Index's Algorithm: The Disclosure WG debated who should be able to inspect an index's algorithm. Regulators hooted out a concern for consumers when information about an index is not publicly available. Some howled that without any public information, an insurer would have no incentive to ensure that the calculation of an index's value is correct. The Disclosure WG decided to require the algorithm be made available to the insurance regulator, but also included a drafting note that each state should consider requiring the algorithm also be made available to consumers.

5. Composition of an Index: As new indexes include other financial instruments or references, such as commodities, currency exchanges, ETFs, futures, or bond rates, the Disclosure WG has been considering whether to permit such indexes to be included in illustrations. It was discussed whether any such "reference" should have a daily published price. The Annuity WG asked for other reference points that should be considered.

IUL SG Seeks to Illuminate Consumer Understanding and Chill Surprise Lapses

Regulators and consumer groups raised the specter that IUL illustrations may not sufficiently warn consumers of:

- The variability of index interest to be credited. Even though illustrations may show values based on maximum, intermediate, and guaranteed values, the illustrations are based on a fixed interest rate for all policy years; and
- The potential for policy lapse if the index interest credited is less than the interest rate assumed in an IUL illustration.

These concerns are heightened for IULs with multipliers because of the interest rate assumed in these IULs' illustrations, and the charges for these IULs are higher than for IULs without multipliers. The IUL SG posited that the higher interest rates being used in IULs with multipliers are a result of how the disciplined current scale is being applied and the number of assets allowed to accumulate at the excess 45 percent disciplined scale rate.

To address these concerns, the IUL SG sought comments on the following questions:

- Should a product with a multiplier feature illustrate a higher scale than a product without multiplier features?
- To what extent should the 145 percent disciplined current scale factor apply to charges supporting bonuses and multipliers?

The IUL SG chair sought votes on five options distinguishing the extent that multipliers should be reflected in IUL illustrations, under which the illustrated rate:

1. Is not adjusted to offset the multiplier charges
2. Is adjusted up to exactly offset the multiplier charges
3. Is adjusted up slightly, up to 1 percent above the multiplier charges on an annual basis
4. Is adjusted up between 1 and 2 percent above the multiplier charges on an annual basis
5. Is adjusted up by more than 2 percent above the multiplier charges on an annual basis

Some of these options would likely limit illustration of the multiplier benefits and thus drive certain multiplier features out of the marketplace. This is similar to AG 49's current approach of limiting the maximum interest rate that can be illustrated by applying a 145 percent limit on the assumed earnings rate. Such solution, however, fails to address the variability of index interest and, depending on the pattern of such variability, may not warn consumers of the potential for policy lapse.

Authored By

Ann Young Black

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